INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statutes involved	2
Statement	2
Reasons for granting the writ	3
Conclusion	12
Appendix	13

CITATIONS

Cases:

American Iron Co. v. *Seaboard Air Line*, 233 U. S. 261	11
Capital Foundry Corp., In re, 83 F. Supp. 413	6
Case v. *Los Angeles Lumber Co.*, 308 U. S. 106	8
Consolidated Rock Co. v. *Du Bois*, 312 U. S. 510	8
Deep Rock Oil Corporation, In re, 113 F. 2d 266, certiorari denied, 311 U. S. 699	9
Lexington Homes, In re, 94 F. Supp. 482	5
Massachusetts v. *Thompson*, 190 F. 2d 10	4, 6
New York v. *Saper*, 336 U. S. 328	3, 7, 8, 9, 12
Northern Pacific Ry. v. *Boyd*, 228 U. S. 482	8
Securities Commission v. *U. S. Realty Co.*, 310 U. S. 434	8
United States v. *Bloom*, No. 100	4, 6
United States v. *General Engineering & Mfg. Co.*, 188 F. 2d 80	3–4, 6

Statutes:

Bankruptcy Act, c. 541, 30 Stat. 544, as amended by the Act of June 22, 1938 (Chandler Act), c. 575, 52 Stat. 840:	
Sec. 77B	8, 9
Sec. 101 (11 U. S. C. 1946 ed., Sec. 501)	14
Sec. 102 (11 U. S. C. 1946 ed., Sec. 502)	14
Sec. 106 (11 U. S. C. 1946 ed., Sec. 506)	15
Sec. 146 (11 U. S. C. 1946 ed., Sec. 546)	15
Sec. 174 (11 U. S. C. 1946 ed., Sec. 574)	8, 16
Sec. 199 (11 U. S. C. 1946 ed., Sec. 599)	10, 17
Sec. 200 (11 U. S. C. 1946 ed., Sec. 600)	7, 17
Sec. 221 (11 U. S. C. 1946 ed., Sec. 621)	8, 18
Sec. 266 (11 U. S. C. 1946 ed., Sec. 666)	18
Sec. 271 (11 U. S. C. 1946 ed., Sec. 671)	19

Statutes—Continued	Page
Internal Revenue Code:	
Sec. 1420 (26 U. S. C. 1946 ed., Sec. 1420)	3, 13
Sec. 1605 (26 U. S. C. 1946 ed., Sec. 1605)	3, 13
Sec. 1627 (26 U. S. C. 1946 ed., Sec. 1627)	3, 13
Miscellaneous:	
6 *Collier on Bankruptcy* (14 ed., 1947)	7, 9, 10
H. Rep. No. 1409, 75th Cong., 1st Sess., pp. 55–56	10
Letter from Charles Oliphant, Chief Counsel, Bureau of Internal Revenue, to Assistant Attorney General Caudle, dated August 20, 1951	5
50 Yale Law Journal 144	9

In the Supreme Court of the United States

OCTOBER TERM, 1951

No. 299

UNITED STATES OF AMERICA, PETITIONER

v.

N. WALSER EDENS AND W. H. CORRY, AS TRUSTEES OF CAROLINA MILLS, INC., A CORPORATION OF SOUTH CAROLINA, DEBTOR

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

The Solicitor General, on behalf of the United States, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fourth Circuit, entered in this case on June 6, 1951.

OPINIONS BELOW

The memorandum opinion of the referee in bankruptcy (R. 1–4) is unreported. The opinion of the District Court (R. 4–8) is reported in 97 F. Supp. 793. The opinion of the Court of Appeals (R. 9–12) is reported in 189 F. 2d 876.

JURISDICTION

The judgment of the Court of Appeals was entered on June 6, 1951. (R. 12.) The juris-

diction of this Court is invoked under the provisions of 28 U. S. C., Section 1254.

QUESTION PRESENTED

Whether, in a corporate reorganization proceeding under Chapter X of the Bankruptcy Act, the United States is entitled to interest on unpaid taxes for the period following the date of the filing of the petition for reorganization.

STATUTES INVOLVED

The pertinent statutory provisions are printed in the Appendix, *infra*, pp. 13–19.

STATEMENT

On November 11, 1948, the debtor, Carolina Mills, Inc., a South Carolina corporation, filed a petition for reorganization under Chapter X of the Bankruptcy Act. (R. 4.) In that proceeding, the United States filed claims for unemployment taxes, federal insurance contributions taxes, and income taxes collected by withholding. No question is raised as to the principal amount of these taxes nor as to interest up to the date of the filing of the reorganization petition. (R. 4.) The referee allowed the full amount of the taxes with interest at the rate of 6% to November 11, 1948. (R. 4.)

The sole question presented is whether the tax claims bear interest subsequent to November 11, 1948, the date of the filing of the reorganization petition. (R. 1.) After a hearing, the bank-

ruptcy referee denied post-petition interest (R. 4), and the District Court adopted and confirmed the referee's decision (R. 8). Upon appeal by the United States, the court below affirmed the order of the District Court, holding that the United States is entitled to interest on its tax claims only to date of the filing of the petition in reorganization. (R. 12.)

REASONS FOR GRANTING THE WRIT

1. The sole issue in this case is whether the United States is entitled to interest on unpaid taxes in a corporate reorganization proceeding under Chapter X of the Bankruptcy Act for the period following the date of the filing of the petition and until the taxes are paid or otherwise satisfied. The Internal Revenue Code provides that when taxes are not paid when due there shall be added as part of the tax interest "at the rate of 6 per centum per annum from the date the tax became due until paid" (26 U. S. C. 1946 ed. 1420, 1605 and 1627, Appendix, *infra*, pp. 13–14). However, this Court held in *New York* v. *Saper*, 336 U. S. 328, that in the case of straight bankruptcy, the Government's right to interest stops at the date of filing of the petition. The question here is whether the same limitation applies in Chapter X proceedings.

The United States is filing, concurrently with this petition, a petition for a writ of certiorari to the United States Court of Appeals for the

Eighth Circuit to review its decision in *United States* v. *General Engineering & Mfg. Co.*, 188 F. 2d 80. That case involves the application of the rule of the *Saper* case to a proceeding for arrangement under Chapter XI of the Bankruptcy Act, and the issue is closely related to the issue here involved.[1]

Still a third related case is now pending before this Court on a petition for certiorari. *United States* v. *Bloom*, No. 100, this Term. That case involves the question of whether interest on federal taxes continues to run, in a state proceeding, after the date of an assignment for the benefit of creditors.

These cases as a group cover the major types of insolvency proceedings apart from straight bankruptcy. The question of whether interest on taxes should be permitted to run during these different proceedings involves related problems of statutory interpretation and policy. The allowance of the petition in this case and in the related cases would afford the Court the opportunity to review the problem in its entirety.

2. Even taken by itself, the instant case presents an important question of continuing importance to the administration of the tax laws and the functioning of corporate reorganization

[1] We have been informed that the Commonwealth of Massachusetts intends to file a petition for certiorari to the First Circuit in another Chapter XI case involving the same issue. *Massachusetts* v. *Thompson*, 190 F. 2d 10.

proceedings under Chapter X of the Bankruptcy Act, c. 541, 30 Stat. 544, Section 101, *et seq.*, as amended by the Act of June 22, 1938 (Chandler Act), c. 575, 52 Stat. 840, Sec. 1 (11 U. S. C. 1946 ed., Sec. 501 *et seq.*). The issue arises in every case in which the United States asserts a claim for taxes in a Chapter X proceeding. The Chief Counsel, Bureau of Internal Revenue, has reported that there are currently pending 199 reorganization cases under Chapter X involving federal tax claims, upon which the estimated interest arising subsequent to the dates of the filing of the petitions exceeds $4,000,000.[2] Obviously, the right of the Government to recover this substantial amount from the assets of the debtors is of importance not only to the Government and the debtors, but also to all other creditors and all parties to the reorganization proceedings.

3. While there is no existing conflict among the circuits on the issue here presented, there is a sufficient diversity of judicial opinion to indicate that the matter is hardly free from doubt. The District Court for the District of New Jersey has reached a conclusion opposed to that of the court below (*In re Lexington Homes*, 94 F. Supp.

[2] Letter from Charles Oliphant, Chief Counsel, Bureau of Internal Revenue, to Assistant Attorney General Caudle, dated August 20, 1951. It is also stated in this letter that both the number of proceedings and the amounts of interest involved appear to be substantially constant from year to year.

482), while a position in accord with that of the court below has led to the denial of post-petition interest by the District Court for the Eastern District of New York (*In re Capital Foundry Corp.*, 83 F. Supp. 413). In the related field of post-petition interest on tax claims under Chapter XI of the Bankruptcy Act, both the First Circuit (*Massachusetts* v. *Thompson, supra*) and the Eighth (*United States* v. *General Engineering & Mfg. Co., supra*) have joined the court below in refusing to allow the Government interest. However, the Court of Appeals for the First Circuit has divided on the issue.

Given this contrariety of judicial opinion, it is the Government's view that this Court should answer the question here presented now. For not only is the question involved in a large number of cases, but the fact is that while only small amounts of money may be involved in any individual case, the aggregate is large. If there are added together the 199 cases involving $4,000,000 arising under Chapter X; the 771 cases involving $1,000,000 under Chapter XI (See petition in *United States* v. *General Engineering and Mfg. Co.*, No. 300, this Term, p. 6); the 810 cases involving $430,000 in assignment proceedings (See petition in *United States* v. *Bloom*, No. 100, this Term, p. 9); and the 985 cases involving $7,000,000 in receiverships (*ibid.*, p. 9), the totals are 2,705 cases involving $12,430,000. Until the issue is finally determined by this Court, the parties

are faced with the alternative of letting adverse initial rulings pass without contest because the amount involved is small, or of repeated appeals in order to attempt to preserve the issue until it can be decided by this Court. Neither alternative to immediate review by this Court would be conducive to the economic, fair, and efficient administration of justice.

4. The court below denied the Government's claim to post-petition interest on the assumption that Chapter X proceedings are a kind of bankruptcy in which creditors have the same rights as in straight bankruptcy.[2] The Government challenges both the assumption and the conclusion. It believes that differences in the purposes and effects of the two types of proceeding are so fundamental that the reasoning underlying the *Saper* case itself would require that interest continue to accrue in Chapter X cases rather than that it be cut off.

The fundamental basis for the holding in the *Saper* case was that, in straight bankruptcy, interest ceases to run on debts other than taxes

[2] The court below, in thus assimilating Chapter X to straight bankruptcy proceedings, placed reliance on Section 200 of the Act (11 U. S. C. 600, Appendix, *infra*, pp. 17–18) (R. 10). This indicates a misconception of the purpose of Section 200 which is intended to relate to such matters as the rights to possession and payment before and after the approval of a petition. It has no relevance to the issue here involved. See 6 *Collier on Bankruptcy* (14th ed., 1947), pp. 2869–2870.

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from the date the petition is filed, and that Congress had, in amendments to the Bankruptcy Act, evinced an intention to assimilate federal tax claims to other debts. See *New York* v. *Saper,* 336 U. S. 328, at 332. However, there is no general rule cutting off interest on debts generally in reorganization cases under Chapter X as of the date of filing and, on the contrary, it appears that interest to the date of consummation of a plan or reorganization is recognized as one of the fundamental rights which must be recognized in order that a plan can be found "fair and equitable" as required by Sections 174 and 221 (2) of the Act. (Appendix, *infra,* pp. 16 and 18.) To be "fair and equitable," a plan must be the product of the "absolute priority" rule announced in *Northern Pacific Ry.* v. *Boyd,* 228 U. S. 482, and reapplied in *Case* v. *Los Angeles Lumber Co.,* 308 U. S. 106, 115–119, and *Securities Commission* v. *U. S. Realty Co.,* 310 U. S. 434, 452. It is a part of this strict priority rule, as this Court stated, in *Consolidated Rock Co.* v. *Du Bois,* 312 U. S. 510, 527, in dealing with interest which had accrued during a Section 77B proceeding (the predecessor of Chapter X), that interest until date of payment is required. Thus this Court found the plan there involved defective, in that:

> no provision is made for the accrued interest on the bonds. This interest is entitled to the same priority as the principal.

Similarly, the Court of Appeals for the Tenth Circuit, in another Section 77B case, stated:

> Where in the administration of the affairs of an insolvent corporation there are claims of different rank, the holders of prior claims are entitled to *interest to the time of payment,* even though the payment thereof may deprive the holders of subsequent claims of any participation in the funds of the bankrupt. [Italics added.] [*In re Deep Rock Oil Corporation,* 113 F. 2d 266, 269 (C. A. 10), certiorari denied, 311 U. S. 699.]

In 6 *Collier on Bankruptcy* (14th ed., 1947), 2817, it is stated, "It is settled, therefore, that in corporate reorganizations, as a general rule, interest on all claims, whether fixed by contract or by the applicable local law, accrues until the date of the consummation of the plan and must be accorded the same priority as the principal of the claim." Many cases to this effect are collected in footnote 15 on page 2817 of that work. See also 50 Yale Law Journal 144.

These cases are not bottomed on the exception to the rule referred to in the *Saper* case (336 U. S. 328, 330, fn. 7) relating to secured obligations, the security for which produces more than sufficient interest to meet the interest accruing on the debt. Rather, they appear to rest on the fact that the purpose of Chapter X is the rehabilitation of distressed corporations, not their

liquidation; the estate is administered as a going concern in order to realize the greatest recovery for the benefit of all parties to the proceeding (See 6 *Collier on Bankruptcy,* 14th ed. (1947) 103). In this context, it would be strange if assets were permitted to be retained by a debtor or trustee, and used to continue the business during reorganization rather than used to pay priority debts without continuing to accrue interest. The estate which enjoys the use of the asset which it owes to another should pay interest for the privilege of its use.

Since interest is not cut off on claims generally in Chapter X reorganization proceedings, it is submitted that there is no basis for treating federal claims for unpaid taxes as inferior. As a matter of fact, federal tax claims, secured or unsecured, are in effect given priority by Section 199 (11 U. S. C. 599, Appendix, *infra,* p. 17), which requires that plans which do not provide for payment of federal taxes in full, except when a lesser amount has been accepted by the Secretary of the Treasury, shall not be confirmed.[4]

[4] The House Committee, which recommended Chapter X, explained the purpose of Sections 199 and 271 (Appendix, *infra,* pp. 17, 19) as follows (H. Rep. No. 1409, 75th Cong., 1st Sess., pp. 55–56):

"The committee believes these new tax provisions will strike a balance between the necessity of safeguarding the Government's tax interests in a debtor corporation, or the new corporation resulting from the reorganization proceedings, and the necessity of scaling down the indebtedness of the debtor corporation in order to make the plan successful.

Thus, under the reasoning of the *Saper* case, that Congress intended to assimilate federal tax claims to other debts, there can be no doubt that interest on such claims should be permitted to run in Chapter X proceedings.

The allowance of interest is very strongly indicated when a plan can be worked out under which stockholders of the debtor are permitted to participate in the reorganization, an eventuality clearly contemplated by Chapter X. Under such a plan the situation is comparable to that in which the debtor in a straight bankruptcy proceeding is found not to be in fact insolvent. *American Iron Co.* v. *Seaboard Air Line,* 233 U. S. 261, 266–267. However, the payment of interest should not be made dependent on whether stockholders are permitted to participate, since rehabilitation of a debtor corporation may be worked out by turning the control over to bondholders with the same result of maintaining the enterprise rather than dismembering it. So far as priority claimants are concerned, the result would be the same.

The court below stated that "It could hardly have been contemplated that a tax claim filed in a Chapter X proceeding should be entitled to

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It is felt that any leniency of this kind on the part of the Government, when its interests are properly safeguarded, will contribute to the success of the plan of reorganization and to the general objective of preserving a business enterprise so that it may not only continue to be economically productive but also productive of future normal taxes."

post bankruptcy interest upon a reorganization of the debtor but not if reorganization should fail and an adjudication of straight bankruptcy should follow." (R. 10.) But this seems no more difficult than the admitted exception to the rule in the case of straight bankruptcy, where interest is permitted if the debtor proves solvent.[5] See *New York* v. *Saper,* 336 U. S. 328, fn. 7, p. 330. All that is required is that if the case is transformed into a straight bankruptcy case, taxes, like other debts, be refused post-petition interest; if a plan can be worked out, then taxes, like other claims, should be allowed interest.

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

PHILIP B. PERLMAN,
Solicitor General.

SEPTEMBER 1951.

[5] If a reorganization petition is filed in the course of a straight bankruptcy proceeding, the interest which a claim bore during bankruptcy, but which would not have been allowed, will be regarded as part of the claim for the purpose of the reorganization. 6 Collier, *supra*, 2819.

APPENDIX

INTERNAL REVENUE CODE:

SEC. 1420. COLLECTION AND PAYMENT OF TAXES.

* * * * *

(b) *Addition to Tax in Case of Delinquency.*—If the tax is not paid when due, there shall be added as part of the tax interest (except in the case of adjustments made in accordance with the provisions of sections 1401 (c) and 1411 at the rate of 6 per centum per annum from the date the tax became due until paid.

* * * * *

(26 U. S. C. 1946 ed., Sec. 1420.)

SEC. 1605. PAYMENT OF TAXES.

* * * * *

(b) *Addition to Tax in Case of Delinquency.*—If the tax is not paid when due, there shall be added as part of the tax interest at the rate of 6 per centum per annum from the date the tax became due until paid.

* * * * *

(26 U. S. C. 1946 ed., Sec. 1605.)

SEC. 1627 [as added by the Current Tax Payment Act of 1943, c. 120, 57 Stat. 126, Sec. 2]. OTHER LAWS APPLICABLE.

All provisions of law, including penalties, applicable with respect to the tax imposed by section 1400 shall, insofar as applicable and not inconsistent with the provisions of this subchapter, be applicable with respect to the tax under this subchapter.

(26 U. S. C. 1946 ed., Sec. 1627.)

Bankruptcy Act, c. 541, 30 Stat. 544 [as amended by the Act of June 22, 1938, c. 575, 52 Stat. 840, Sec. 1]:

CHAPTER X—CORPORATE REORGANIZATIONS

* * * * *

SEC. 101. The provisions of this chapter shall apply exclusively to proceedings under this chapter.

(11 U. S. C. 1946 ed., Sec. 501.)

SEC. 102. The provisions of chapters I to VII, inclusive, of this Act shall, insofar as they are not inconsistent or in conflict with the provisions of this chapter, apply in proceedings under this chapter: *Provided, however,* That section 23, subdivisions h and n of section 57, section 64, and subdivision f of section 70, shall not apply in such proceedings unless an order shall be entered directing that bankruptcy be proceeded with pursuant to the provisions of chapters I to VII, inclusive. For the purposes of such application, provisions relating to "bankrupts" shall be deemed to relate also to "debtors", and "bank-

ruptcy proceedings" or "proceedings in bankruptcy" shall be deemed to include proceedings under this chapter. For the purposes of such application the date of the filing of the petition in bankruptcy shall be taken to be the date of the filing of an original petition under section 128 of this Act, and the date of adjudication shall be taken to be the date of approval of a petition filed under section 127 or 128 of this Act except where an adjudication had previously been entered.
(11 U. S. C. 1946 ed., Sec. 502.)

SEC. 106. For the purposes of this chapter, unless inconsistent with the context—

(1) "claims" shall include all claims of whatever character against a debtor or its property, except stock, whether or not such claims are provable under section 63 of this Act and whether secured or unsecured, liquidated or unliquidated, fixed or contingent;

* * * * *

(3) "corporation" shall mean a corporation, as defined in this Act, which could be adjudged a bankrupt under this Act, and any railroad corporation excepting a railroad corporation authorized to file a petition under section 77 of this Act;

* * * * *

(11 U. S. C. 1946 ed., Sec. 506.)

SEC. 146. Without limiting the generality of the meaning of the term "good

faith", a petition shall be deemed not to be filed in good faith if—

(1) the petitioning creditors have acquired their claims for the purpose of filing the petition; or

(2) adequate relief would be obtainable by a debtor's petition under the provisions of chapter XI of this Act; or

(3) it is unreasonable to expect that a plan of reorganization can be effected; or

(4) a prior proceeding is pending in any court and it appears that the interests of creditors and stockholders would be best subserved in such prior proceeding.

(11 U. S. C. 1946 ed., Sec. 546.)

SEC. 174. After the hearing, as provided in section 169 or section 170 of this Act, and, if a plan has been submitted to the Securities and Exchange Commission, as provided in section 172 of this Act, then after the filing of the report or notice that it will not be filed, or after the expiration of the time for its filing, whichever first occurs, the judge shall enter an order approving the plan or plans which in his opinion comply with the provisions of section 216 of this Act, and which are fair and equitable, and feasible, and shall fix a time within which the creditors and stockholders affected thereby may accept the same.

(11 U. S. C. 1946 ed., Sec. 574.)

* * * * *

SEC. 199. If the United States is a secured or unsecured creditor or stockholder of a debtor, the claims or stock thereof shall be deemed to be affected by a plan under this chapter, and the Secretary of the Treasury is hereby authorized to accept or reject a plan in respect of the claims or stock of the United States. If, in any proceeding under this chapter, the United States is a secured or unsecured creditor on claims for taxes or customs duties (whether or not the United States has any other interest in, or claim against the debtor, as secured or unsecured creditor or stockholder), no plan which does not provide for the payment thereof shall be confirmed by the judge except upon the acceptance of a lesser amount by the Secretary of the Treasury certified to the court: *Provided,* That if the Secretary of the Treasury shall fail to accept or reject a plan for more than ninety days after receipt of written notice so to do from the court to which the plan has been proposed, accompanied by a certified copy of the plan, his consent shall be conclusively presumed. (11 U. S. C. 1946 ed., Sec. 599.)

SEC. 200. Where not inconsistent with the provisions of this chapter, the rights, duties, and liabilities of creditors and of all other persons with respect to the property of the debtor shall be the same, before the approval of the petition, as in a bankruptcy proceeding before adjudication and,

upon the approval of the petition, as in a bankruptcy proceeding upon adjudication.

(11 U. S. C. 1946 ed., Sec. 600.)

SEC. 221. The judge shall confirm a plan if satisfied that—

(1) The provisions of article VII, section 199, and article X of this chapter have been complied with;

(2) the plan is fair and equitable, and feasible;

* * * * *

(11 U. S. C. 1946 ed., Sec. 621.)

SEC. 266. In addition to the notices elsewhere expressly provided, the clerk and, in the case of a reference, the referee, after such reference, shall forthwith transmit to the Secretary of the Treasury copies of all petitions, answers, orders, and applications, as more specifically enumerated in section 265 of this Act, and copies of such other papers filed in the proceedings as the Secretary of the Treasury may request or which the court may direct be transmitted to him. Copies of the opinions or reports, if any, of the judge, referee, or special master, with respect to the matters so enumerated, shall also be transmitted to the Secretary of the Treasury. And order fixing the time for confirming a plan which affects claims or stock of the United States shall include a notice to the Secretary of the Treasury of not less than thirty days.

(11 U. S. C. 1946 ed., Sec. 666.)

SEC. 271. Any provision in this chapter to the contrary notwithstanding, all taxes which may be found to be owing to the United States or any State from a debtor within one year from the date of the filing of a petition under this chapter and have not been assessed prior to the date of the confirmation of a plan under this chapter, and all taxes which may become owing to the United States or any State from a receiver or trustee of a debtor or from a debtor in possession, shall be assessed against, may be collected from and shall be paid by the debtor or the corporation organized or made use of for effectuating a plan under this chapter: *Provided, however,* That the United States or any State may in writing accept the provisions of any plan dealing with the assumption, settlement, or payment of any such tax.

(11 U. S. C. 1946 ed., Sec. 671.)

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